A REVIEW OF INCENTIVES PROVIDED BY STATES TO THE FILM INDUSTRY AND THE IMPLICATIONS FOR NEBRASKA

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Prepared
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This report is intended to:

- provide a review of the changes taking place in the film/video/commercial television industry;
- review how states have responded to these changes through their economic development programs, particularly with respect to incentives; and
- the implications of these changes for Nebraska.

The end question is whether a reasonable case can be made for greater efforts by the State of Nebraska to promote development of this industry.

Changes in the Motion Picture and Television Production Industry

Recent and continuing technology changes on the producer side and the explosion in the variety of viewing opportunities on the user side have made the film industry much more dynamic. This is occurring to the point that film production, and related activities, have become a growth industry across the country.

The motion picture, television and commercial production industry has undergone tremendous changes, which are accelerating as time passes. The Motion Picture Association recently reported that motion picture theater ticket sales had declined from 4.6 billion in 1948 to 1 billion in the early 2000s. There has been a proliferation of hundreds of TV channels available for home viewing through multiple cable and satellite networks, not to mention the rental market for VCRs, DVDs and the downloading of video materials from the internet. Businesses have also substantially expanded the use of viewing for everything from training and instructional presentations to marketing.

These changes have been accompanied by equally remarkable changes in how film-related productions are made. The advent of the camcorder in the 1980s and digital video in the 1990s lowered the historic barriers to production by small companies. In addition, the advance of the personal computer and associated software has lowered the costs of editing, mixing, graphics and other post-production activities so that the mechanics of film production are available to a wide variety of small producers who enter the market as non-traditional independent production companies.

These changes have vastly altered the structure and location of the film-related industry. It is no longer dominated by a few large producers located in California and New York. Not only have other places across the U.S. seen more production activity, but in the 1990s, with the dollar strong internationally, many films were made in foreign countries where costs were lower and incentives aggressive. More recently, with the downturn in the value of the dollar, film producers are undertaking even more projects in the U.S. In 2005, as reported by the Motion Picture Association, the Bureau of Labor Statistics indicated that there were 160,000 businesses in the industry, 85% of which employed fewer than 10 people. Nationwide, there were 1.3 million reported employees in all sectors of the industry, earning an average annual wage of $73,000. Of the films released that year, 65% were made by small independent producers, up from 43% just 10 years earlier.

For the year 2006, the U.S. Bureau of the Census reported 106 establishments in the 'Motion Picture and Sound Recording' industry in Nebraska, 10% more than in 1998. These establishments employed an estimated 1,400 workers, up 17% from 1998. There is significant difficulty, however, with the credibility of federal statistics reported on employment in the film production portion of the industry. Over half of those hired for projects (production, post-production and distribution) are independent free lance contractors who are not captured by the data-gathering methodology used by federal data sources. These contractors include most independent performing artists, agents, managers, writers, casting businesses, costume designers and others. The bottom line is that the industry is much larger than generally assumed.

Economic Development Responses by States

The changed viewing and technological characteristics of the film-related production industry has vastly expanded the number of producers, productions and the places where they can be made: smaller companies, mobile/flexible technology and an increasingly diversified market demanding more productions. One of the natural consequences of these changes has been growing interest from states in increasing the number of in-state production projects, which increase economic activity and provide economic diversification.

All states have taken the minimum step of establishing responsibility for responding to and encouraging film activity, usually in the agency responsible for promoting economic development and/or tourism. Most states, including Nebraska, have established a film office as a focal point for such activities. Furthermore, most states (over 40) have also taken the aggressive step of initiating financial incentives to encourage the growth of in-state production companies and projects. The table attached to the end of this report, from a 2009 study by Economic Research Associates for the Pennsylvania legislature, contains a list of the states and the kinds of incentives they either do or do not provide. The general formula has been to statutorily identify a minimum dollar threshold of in-state expenditure to qualify for the incentives; a percentage of tax credit that can be applied to wage and production expenditures (frequently refundable or transferable); and the tax obligations against which the credits can be used.

A more specific and relevant focus for Nebraska is a summary of incentives provided by states adjacent to Nebraska. Of those six (Colorado, Wyoming, South Dakota, Iowa, Missouri and Kansas) only South Dakota joins Nebraska in not having yet initiated film production incentives. The incentives in each state can be summarized as follows:

- *Colorado:* Established incentives in 2006. Provides a 10% cash rebate for all in-state costs when 75% of the crew are in-state residents and expenditures are at least $100,000.

- *Wyoming:* Established incentives in 2007. Provides a cash rebate of 12%-15% of in-state expenditures of at least $200,000.

- *Iowa:* Established incentives in 2007. Provides a transferable and/or refundable income tax credit equal to 25% of qualified in-state expenditures and 25% of investment (a 50% total credit) when such spending is at least $100,000. There is also a 100% income tax exclusion for Iowa-based businesses and residents.

- *Missouri*: Established incentives in 2005. Provides a tax credit (applicable against any of several kinds of taxes) of 35% of in-state expenditures of at least $100,000 ($50,000 for projects less than 30 minutes in length).

- *Kansas:* Established incentives in 2007. Provides a non-refundable, non-transferable income tax credit equal to 30% of in-state expenditures when those are at least $100,000.

Nebraska's Film Office program, in the absence of incentives, has concentrated on providing technical assistance and location information to potential projects. In 2002, the office commissioned Economic Research Associates, one of the premier film industry analysts, to complete a state film opportunity study and planning process. The major recommendation not yet implemented is the establishment of film industry incentives that would make Nebraska competitive with surrounding states.

Are Film Incentives a Good Legislative Investment?

The straightforward answer to this question is that it is not always easy to tell, but it is clear that states without incentives, including Nebraska, are losing film projects. So many states have initiated incentives that are clearly a factor in the location of projects. This is particularly true when the equipment and people involved in shooting projects are easily transportable. Indeed, an early question to the Nebraska Film Office in virtually every discussion with potential producers (10 to 15 per week) is, "Do you offer incentives?" There have been a few states (surprisingly few) who have commissioned studies looking at the return-on-investment question, and we will review those here.

The appropriate question is whether the benefit-cost ratio is greater than one with respect to the amount of tax revenues generated by film projects versus the tax incentives given on film projects. That is, are the tax benefits greater than the tax cost.

For this report, the methodology sought for reviewing state investment worthiness was, first, a determination of the tax credits used by eligible projects; second an estimate of the primary taxes paid back as a direct result of participant spending on the project; and, third, an estimate of the taxes paid as a result of secondary activity (the multiplier effect) related to the project. The rationale for estimating the "return" (tax revenues) on economic development projects like film production activity, is to include not only project taxes paid by the company but also the taxes paid as a result of re-spending by recipients of the direct expenditures. This is typical multiplier analysis. Three sates that have used this kind of analysis and the results are the following:

New Mexico: The most recent, and thorough, state study was completed in early 2009 by Ernst and Young on the film incentive program in New Mexico. That state's incentive program was started in the year 2000 and in 2006 the incentive was set at 25% of payments to New Mexico residents, non-resident actors and all direct production and post-production expenses subject to New Mexico taxes. That study estimated that $47.1 million of state tax credits had yielded local and state taxes of $70.5 million. This is essentially a return of $1.50 to state and local governments for each dollar of incentive.

New York: A 2007 study in New York, also completed by Ernst and Young and similar to the New Mexico study, estimated that $610 million in state tax credits had yielded $2.7 billion in tax collections --- a substantially higher return than in New Mexico.

Pennsylvania: An Economic Research Associates 2007-08 study estimated that $58.2 million in state tax credits had yielded $62.7 million in state tax revenues, or about $1.08 for each dollar of incentive.

Cost Benefit Analysis Example for The Nebraska Film Industry

What follows here is an example of a tax credit benefit-cost estimate for a typical Nebraska project. It uses the methodology described above. The dollar figures are taken from estimates provided by the producer on a recent film production shot in Blair, Omaha and the surrounding area. The project was 90% funded by local investors. The hypothetical tax incentive is a 20% refundable or transferable income tax credit that applies to all production expenditures in Nebraska.

Case scenario: feature length film with a total $1,795,000 budget

Budget breakdown:

Total budget for project:	$1,795,000
Pre-production	$ 430,000
Production	$ 960,000
Post-production	$ 405,000

Percent of costs spent in Nebraska:	
Pre	70%
Production	85%
Post	60%
Labor	75%

Pre-pro $ spent in Nebraska $430,000 X .70 =	$301,000
Production $ spent in Nebraska $960,000 X .85 =	$816,000
Post-Production $ spent in Nebraska $405,000 X .60 =	$243,000
Project Expenditures in Nebraska:	$1,360,000

The spending for Nebraska labor was 75% of the production costs, or $1,360,000 X .75 = $1,020,000 spent on over 100 Nebraska hires at an average wage of $35/hour, which is more than double the $17.43 average hourly wage for all employees in Nebraska in 2008.

Incentive Cost to the State

Assuming Nebraska offers a 20% incentive on production costs in the state and that this project has $1,000,000 of eligible expenditures, the state tax credit incentive would be $200,000:
$1,000,000 X .20 = $200,000 Nebraska Incentive

Benefits to Government in New Revenues

The benefits for Nebraska will be the return of tax revenues from the cost of production and the multiplier effects:

6% Tax on Production Company's income: $100,000 X .06 = $6,000
Non-labor expenditures sales tax (5%): $340,000 X .05 = $17,000
Local sales tax: $340,000 X .015 = $5,100
Income taxes (6%) paid by labor: $1,020,000 X .06 = $61,200
Retail sales taxes paid by labor (retail sales = 1/2 of labor income)
$1,020,000 X .5 = $510,000 X sales tax .05 = $25,500
Local sales tax: $510,000 X .015 = $7,650
Basic revenues generated for Nebraska are:
Business income tax + Labor income tax + Sales tax = $122,450

The approximate multiplier for this industry in Nebraska, according to IMPLAN (Impact Analysis for Planning, an input-output model used by states for economic analysis) is 1.76. This means total direct, indirect and induced tax revenues as a result of this project would be $122,450 X 1.76 = $215,512. This represents a return of $1.08 in taxes for each dollar of tax incentive. And this does not include the possible tourism and property tax impacts, nor the potential capital investment in sound stages and facilities.

Does this represent a good investment? It is at least a positive one.

Conclusions and Recommendations

Conclusions:

- The film industry is very diverse and growing, with increasing development opportunities for states.
- States have become very aggressive in their attempts to attract film-related projects and to retain projects that are leaving; about 40 states have initiated project incentives.
- Of the six adjacent states, only one is not offering incentives.
- Without question, Nebraska is losing projects to surrounding states, and others, due to the absence of incentives.
- The industry is, indeed, responsive to incentives and now expect incentives in some effective form.
- The 2002 Economic Research Associates industry study and Nebraska film plan recommended incentives as a critical part of any effort to be more competitive with adjacent states.

Recommendations:

- The Nebraska legislature should pass legislation initiating film production incentives; in the current competitive environment, to do nothing sends a continuing negative message to the industry --- particularly to Nebraska's home grown producers. And the result will be the loss of potential projects from a growing industry.

- Elements of the legislation should include:

  - Tax credits should be eligible for pre-production, production and post-production spending within Nebraska, with a reasonable minimum spending threshold for eligibility.
  - The tax credits should be either refundable (as in the current micro-enterprise development program) or transferable (as was allowed in the ethanol development incentive program).
  - The total tax credits allowed for the program should be sufficient to support several projects, thereby making film production a sustainable industry in Nebraska.

Table 22 – Current Film Production Incentives by State

State	Production Co. Tax Credit	Carry Forward Period	Project Caps/ Funding per Year	Infrastructure Tax Credit	Wage/ Withholding Credits	Sales Tax Exemption	Lodging Tax Exemption
Alabama	25% ®		$5 million in FY 2009		35%	✓	✓
Alaska	30% (T)	3 years	Aggregate tax credits ≤ $100 million		10%, plus 2% rural	No Tax State	
Arizona	20-30% (T)	5 years	$8 million per project in 2009	15% of base investment		✓	
Arkansas*	15% CR		Unknown at this time		10%		
California*	20-25%	5 years	$100 million per fiscal year beginning 2011			✓	✓
Colorado	10% CR		FY 2007-08 $600,000				✓
Connecticut	30% (T)	3 years	None for production expense and infrastructure	10-20%		✓	✓
Delaware	NONE						
Dist. of Columbia	10% CR		$1.6 million per year			Grant may apply	
Florida	15% CR + bonuses		$200-$400K on residents/$5 million in FY 2008			✓	
Georgia	20% (T) + 10% bonus	5 years	$500,000 per person per project/No annual cap			✓	
Hawaii	15%-20% ®		$8 million per project/ No annual cap				
Idaho	20% CR		$500,000 per project[1]			✓	✓
Illinois	30% (T)	5 years	Up to $100K per resident/No annual cap		15%		✓

State	Production Co. Tax Credit	Carry Forward Period	Project Caps/ Funding per Year	Infrastructure Tax Credit	Wage/ Withholding Credits	Sales Tax Exemption	Lodging Tax Exemption
Indiana	15% ®		No per project cap/$5 million annual funding			✓	✓
Iowa	25% (T)	5 years	Investor's pro rata share	25% (T)			✓
Kansas	30%		$2 million per year				✓
Kentucky	NONE	✓	✓				
Louisiana	25% ® (T)		No annual caps		10%		
Maine			Wages capped @ $ 1 million per person/No annual cap		10%-12%	✓	✓
Maryland	25% CR		No per project cap/$4 million budget FY 08-09			✓	
Massachusetts	25% ® (T)	5 years	None		25%	✓	
Michigan	40-42% ® & T	10 years	$2 million cap per person	25% (T)	30%		✓
Minnesota	15-20% CR		$1.3 million for FY 2009			✓	✓
Mississippi	20% CR		$8 million per project/$20 million FY cap		20-25%	✓	
Missouri	35% (T)	5 years	$4.5 million annual funding				
Montana	9% ®		$50K on resident wages/ No annual cap		14%	No Tax State	✓
Nebraska[P]			NONE				✓
Nevada			NONE				✓

State	Production Co. Tax Credit	Carry Forward Period	Project Caps/ Funding per Year	Infrastructure Tax Credit	Wage/ Withholding Credits	Sales Tax Exemption	Lodging Tax Exemption
New Hampshire			NONE			No Tax State	
New Jersey	20% (T)		$10 million per year			✓	✓
New Mexico	25% ®		$5 million cap per project/No annual cap			✓	
New York	30% ®		$75 million in 2009	4-5% eligible investment base		✓	
North Carolina	15% ®		$1 million on compensation and $7.5 million per feature/No annual cap			✓	✓
North Dakota			NONE				✓
Ohio			NONE				✓
Oklahoma	5-15% CR		$5 million per year			✓	
Oregon	20% CR		No per project cap/$5 million in annual funding		16.2%	No Tax State	✓
Pennsylvania	25% (T)	3 years (recipient only)	$15 million per project/$75 million in annual funding				✓
Rhode Island	25% (T)		Annual cap of $15 million	Lesser of 40% of the cash investment or 20% of the budget			
South Carolina	30% CR		No per project cap/$5.5 million in annual funding & 10 million for wage rebate		10-20% CR	✓	✓

State	Production Co. Tax Credit	Carry Forward Period	Project Caps/ Funding per Year	Infrastructure Tax Credit	Wage/ Withholding Credits	Sales Tax Exemption	Lodging Tax Exemption
South Dakota			NONE			✓	✓
Tennessee	13-17% G & ® + bonuses		$12 million per year			✓	✓
Texas	5% G + bonus		$2 million per feature, $2.5 million per TV, $200,000 per commercial/$10 million in annual funding		includes resident wages	✓	✓
Utah	15% CR & ®		$500,000 per project/$7.8 million FY 2009-10			✓	✓
Vermont			NONE			✓	✓
Virginia	CR - amt. discretionary		$200,000 for FY 09			✓	✓
Washington	20% CR		Annual cap of $3.5 million		includes resident wages	✓	✓
West Virginia	27% (T) + bonus	2 years	No per project cap/$10 million in annual funding			✓	✓
Wisconsin[2]	25% ®	15 years	$25K per person cap for residents/no annual cap		includes resident & non-resident wages	✓	
Wyoming	12-15% CR		Annual cap of $2 million			*	✓

* Tax credit approved within past 2 months.
[1] Idaho's rebate has been approved but not yet funded.
[2] Budget proposal exists to replace current program with $1 million program that would provide $500K annual for infrastructure projects.
® =refundable tax credit, CR = cash rebate, G = Grant, P = pending legislation, (T) = transferable tax credit
Source: Individual film commissions; Entertainment Partners (February 2009); and Economics Research Associates